

SANDY HOOK WATER DISTRICT
AUDIT OF FINANCIAL STATEMENTS
For The Year Ended December 31, 2012

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INDEPENDENT AUDITORS' REPORT

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Sandy Hook Water District, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for Qualified Opinion

Because of the inadequacy of accounting records, we were unable to obtain sufficient, appropriate audit evidence regarding the amounts at which inventory is recorded in the accompanying statements of financial position at December 31, 2012 (stated at \$0).

Qualified Opinion

In our opinion, except for the possible effects of the matter discussed in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Sandy Hook Water District, as of December 31, 2012, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis and budgetary comparison information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2013, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky

October 21, 2013

**SANDY HOOK WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2012**

ASSETS

CURRENT ASSETS

Cash - Unrestricted	\$ 106,928
Cash - Restricted	233,923
Accounts Receivable	43,367
Prepaid Expenses	<u>7,145</u>

Total Current Assets 391,363

NONCURRENT ASSETS

Capital Assets - Net of Accumulated Depreciation

Land	142,498
Land Improvements	9,249
Wells and Springs	35,268
Electric Pumping Equipment	13,953
Transmission and Distribution	5,497,705
Treatment Plant	107,611
Structures	766,745
Miscellaneous Equipment	20,047
Furniture and Fixtures	530
Transportation Equipment	<u>7,749</u>

Total Noncurrent Assets 6,601,355

TOTAL ASSETS \$ 6,992,718

The accompanying notes are an integral part of the financial statements.

**SANDY HOOK WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2012**

LIABILITIES AND NET POSITION

CURRENT LIABILITIES

Accrued Interest	\$ 27,097
Due to City of Sandy Hook	12,374
Accrued Taxes	5,396
Accrued Salaries	894
Accrued Retirement Expense	4,270
Compensated Absences	4,277
Accounts Payable	14,765
Bonds Payable	<u>28,600</u>

Total Current Liabilities	97,673
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LONG-TERM BONDS PAYABLE	1,051,600
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OTHER LIABILITIES

Customer Deposits	<u>23,034</u>
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TOTAL LIABILITIES	1,172,307
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NET POSITION

Invested in Capital Assets, Net of Related Debt	5,521,155
Restricted for:	
Debt Service	107,758
Depreciation Reserve	86,260
Sewer Collections	12,374
Unrestricted	<u>92,864</u>

TOTAL NET POSITION	<u>5,820,411</u>
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TOTAL LIABILITIES AND NET POSITION	<u><u>\$ 6,992,718</u></u>
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The accompanying notes are an integral part of the financial statements.

SANDY HOOK WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSTION
For The Year Ended December 31, 2012

OPERATING REVENUES

Water Sales	\$ 441,171
Service Revenues	18,760
Miscellaneous Revenues	<u>8,495</u>

Total Operating Revenues	468,426
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OPERATING EXPENSES

Water Expenses	
Advertising	1,214
Contract Labor	260
Depreciation	186,409
Dues and Subscriptions	1,983
Health Insurance	39,741
Legal and Accounting Services	43,130
Miscellaneous	23,685
Office Supplies	7,416
Payroll Taxes	14,066
Postage	5,537
Property Insurance	14,009
Repairs and Maintenance	31,025
Retirement	32,251
Salaries and Wages	190,245
Supplies and Testing	41,417
Taxes and Licenses	1,115
Telephone and Utilities	64,252
Travel and Automobile	<u>17,034</u>

Total Operating Expenses	<u>714,789</u>
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NET OPERATING INCOME (LOSS)	(246,363)
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The accompanying notes are an integral part of the financial statements.

SANDY HOOK WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
For The Year Ended December 31, 2012

NON OPERATING REVENUES (EXPENSES)

Interest Expense	(53,664)
Interest Income	<u>496</u>
Total Non Operating Revenues (Expenses)	<u>(53,168)</u>
Net Change in Net Position	<u>(299,531)</u>
Net Position - Beginning	<u>6,119,942</u>
Total Net Position - Ending	<u><u>\$ 5,820,411</u></u>

The accompanying notes are an integral part of the financial statements.

**SANDY HOOK WATER DISTRICT
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2012**

CASH FLOWS FROM OPERATING ACTIVITIES

Payments from Customers	\$ 485,255
Payments for Sewer Collection Fees	6,600
Payments to Vendors	(255,485)
Payments for Payroll and Related Expenses	<u>(278,345)</u>
Net Cash Provided (Used) by Operating Activities	(41,975)

**CASH FLOWS FROM CAPITAL AND
RELATED FINANCING ACTIVITIES**

Payments on Capital Debt	<u>(81,664)</u>
Net Cash Provided (Used) by Capital and Related Financing Activities	(81,664)

CASH FLOWS FROM INVESTING ACTIVITIES

Cash Received from Interest	<u>496</u>
Net Cash Provided (Used) by Investing Activities	<u>496</u>
INCREASE (DECREASE) IN CASH	(123,143)
CASH AT BEGINNING OF YEAR	<u>463,994</u>
CASH AT END OF YEAR	<u><u>\$ 340,851</u></u>

The accompanying notes are an integral part of the financial statements.

**SANDY HOOK WATER DISTRICT
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2012**

Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:

Net Operating Income	\$ (246,363)
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	186,409
Changes in Assets (Liabilities):	
Accounts Receivable	7,191
Prepaid Expenses	(1,135)
Accounts Payable	(757)
Accrued Compensated Absences	(1,645)
Accrued Salaries	(3,239)
Accrued Taxes	(1,514)
Accrued Payroll Taxes	3,842
Due To City of Sandy Hook	12,369
Accrued Retirement Expenses	(1,002)
Customer Deposits	3,869
	<hr/>
Net Cash Provided (Used) by Operating Activities	<u><u>\$ (41,975)</u></u>

Supplementary Information

Interest Paid	<u><u>\$ 53,664</u></u>
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The accompanying notes are an integral part of the financial statements.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Sandy Hook Water District (the District) is presented to assist in understanding the District's financial statements. The financial statements and notes are representations of the District's management, who are responsible for their integrity and objectivity. These accounting policies, as applied to the aforementioned financial statements, conform to generally accepted accounting principles applicable to governmental units.

Regulatory Requirements

The District is subject to the regulatory authority of the Kentucky Public Service Commission ("PSC") pursuant to KRS 278.040.

Organization & Activity

The District was created in accordance with Chapter 74 of the Kentucky Revised Statutes in 1957. The purpose of the District is to provide water services to residents in Sandy Hook, Kentucky and the surrounding area.

Financial Reporting Entity

The District complies with GASB Statements No. 14, "The Financial Reporting Entity" and No. 39, "Determining Whether Certain Organizations Are Component Units." These Statements establish standards for defining and reporting on the financial reporting entity. They define component units as legally separate organizations for which the officials of the primary government are financially accountable and other organizations for which the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The District is not considered a component unit of any other governmental unit for financial reporting purposes.

The District considered all potential component units in determining what organizations should be included in its financial statements. Based on an evaluation of the established criteria, management determined that there were no component units to include in the District's financial statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The District's financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America. The District applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

Board (APB) Opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

All activities of the District are accounted for within a single proprietary (enterprise reporting entity). Proprietary entities are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expense, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the Balance Sheet. Net Position are segregated into "invested in capital assets, net of related debt"; "restricted"; and "unrestricted" components.

The District's various bond resolutions or ordinances require the establishment of certain accounts, which are referred to as "funds". These required accounts are maintained as part of accounting records of the Water Fund. They include the Sinking Fund (Debt Service), Revenue Fund and Depreciation Reserve Fund (Repairs and Maintenance). These are not "funds" as the term is used in generally accepted accounting principles, but are separate "accounts" used to delineate the accounting and reporting for bond related money and repayment security requirements. The balances and activity that occur in these various accounts represent specific segments of the Water Utility enterprise fund as reported in the District's financial statements.

The enterprise fund used by the District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with the District's ongoing operations. The principal operating revenues are charges to customers for sales and services that are provided to them. The District also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the water and sewer systems. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Budgeting

In accordance with Kentucky Revised Statute 65.065, the District is required to submit a balanced budget to the Elliott County Fiscal Court prior to December 1. The budget includes proposed expenditures and means of financing them for the upcoming year. Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. Expenditures may not legally exceed budgeted appropriations at the fund level. All appropriations lapse at fiscal year end.

Allowance for Doubtful Accounts

No allowance for doubtful accounts has been established. The District considers all receivables to be fully collectible based on their strict cut-off policy. If amounts become uncollectible, the amounts due are offset by any customer deposit held and the balance charged to operations when that determination is made.

Accounts Receivables

Accounts receivables are stated at face amount and include billed and unbilled receivables due as of 12/31/2012. Unbilled receivables represent income earned during the current year, but not yet billed to the customer. The billing mailed on December 28, 2012 was for customer usage from approximately November 25 through December 25, 2012. The entire amount is considered accounts receivable as of December 31, 2012. The billing mailed on January 30, 2013 was for usage from approximately December 25, 2012 through January 25, 2013. Approximately six days of this billing is considered unbilled receivables at December 31, 2012.

Deposits and Investments

KRS 66.480 authorizes the District to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, Plant, and Equipment

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., water distribution systems, sewer collection systems and similar items) are reported as a component of noncurrent assets in the basic financial statement. Capital assets are generally defined by the District as being those assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed.

The reported value excludes the costs of normal maintenance and repairs that are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate.

Depreciation is charged as an expense against operations. Capital assets of the authority are depreciated using the straight-line method over their estimated useful lives in years.

The depreciation expense provided on proprietary fund assets during the period ended December 31, 2012 is \$186,409.

Capitalized Interest On Indebtedness

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is reflected in the capitalized value of the asset constructed. The total interest expense incurred by the District during the current fiscal year was \$53,664. No capitalizable interest was incurred during the year ended December 31, 2012.

Cash and Cash Equivalents

For the purpose of these financial statements, cash and cash equivalents consist of unrestricted and restricted cash on hand, demand and savings deposits and certificates of deposit.

Inventory and Prepaid Items

The District maintains an inventory of supplies to make minor repairs to the water district systems. It is the policy of the water district to expense the items as they are purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. An example of a prepaid item for the District is property and liability insurance premiums.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Restricted Net Position

Some of the District's assets have certain constraints that have been placed on how they can be used. By definition, restricted assets are cash or other assets, whose use in whole or in part are restricted for specific purposes bound by virtue of contractual agreements, legal requirements or enabling legislation.

Certain proceeds of the District's revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net position because their use is limited by applicable bond covenants. The "debt service" accounts are used to segregate resources accumulated for debt service payments over the next twelve months. The "depreciation reserve" account is used to report resources set aside to meet unexpected contingencies or to fund asset renewals, replacements and extensions.

The District collects sewer revenues on behalf of the City of Sandy Hook. The amount owed to the City of Sandy Hook as of December 31, 2012 is reported as a component of restricted net position.

Federal Income Tax

The District is exempt from federal income tax since it is a governmental entity. Accordingly, the financial statements include no provision for income taxes.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that effect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE B - RESTRICTIONS ON CASH

Bond Sinking Fund

Deposits into Bond Sinking Funds are required to be made monthly in order to accumulate funds for payment of bond principle and interest. At December 31, 2012, \$55,079 was required to be on deposit to meet payments of interest and principal due on bonds at January 1, 2013. The balance in this account at December 31, 2012 was \$107,758.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE B - RESTRICTIONS ON CASH (Continued)

Depreciation Reserve

The Depreciation Reserve Account is being maintained as required in various bond documents. The District was required to deposit \$2,760 per month into the account. At December 31, 2012, \$94,400 was the required balance of the Depreciation Reserve account. The District had \$86,260 in this account for the purpose of maintaining the water system.

Restricted Cash Accounts

The District is required to maintain special deposit accounts for customer deposits and long-term debt obligations. The following is a listing of restricted cash accounts of the District:

Customer Deposits Account	\$ 27,531
Sewer Revenue Held for the City of Sandy Hook	12,374
Bond and Interest Sinking Fund	107,758
Depreciation Reserve Fund	<u>86,260</u>
Total Restricted Cash Accounts	<u><u>\$ 233,923</u></u>

NOTE C - CASH AND INVESTMENTS

The primary government maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the county and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. As of December 31, 2012, these requirements were met.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the District's deposits may not be returned to it. As of December 31, 2012, the bank balance was \$355,758. The bank balances were either insured by FDIC or covered by pledged collateral, as of December 31, 2012.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE D - PROPERTY, PLANT, AND EQUIPMENT

The District's major classes of utility capital assets and accumulated depreciation are shown below:

	Balance 12/31/2011	Additions	Disposals	Balance 12/31/2012
Land	\$ 142,498	\$	\$	\$ 142,498
Land Improvements	16,320			16,320
Buildings and Building Improvements	906,007			906,007
Wells and Springs	78,896			78,896
Transmission and Distribution	7,283,195			7,283,195
Treatment Plant	420,514			420,514
Electric Pumping Equipment	30,344			30,344
Miscellaneous Equipment	102,087			102,087
Furniture and Fixtures	5,876			5,876
Transportation Equipment	62,266			62,266
Total	\$ 9,048,003	\$	\$	\$ 9,048,003
Accumulated Depreciation:				
Land Improvements	5,983	1,088		7,071
Buildings and Building Improvements	121,564	17,699		139,263
Wells and Springs	41,706	1,922		43,628
Transmission and Distribution	1,639,724	145,766		1,785,490
Treatment Plant	301,875	11,028		312,903
Electric Pumping Equipment	15,085	1,306		16,391
Miscellaneous Equipment	79,731	2,309		82,040
Furniture and Fixtures	5,292	53		5,345
Transportation Equipment	49,279	5,238		54,517
Total	2,260,239	186,409		2,446,648
Fixed Assets Net of A/D	\$ 6,787,764	\$ (186,409)	\$ 0	\$ 6,601,355

SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012

NOTE E - BONDS PAYABLE

1. Waterworks Revenue Series 1988

On May 25, 1988, the District entered into an agreement with Rural Development to issue \$237,000 in Waterworks Revenue Bonds for the purpose of financing the cost of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 6.25% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2012, the principal balance outstanding was \$172,000. Debt service requirements for year ending December 31, 2012, and thereafter is as follows:

<u>Year Ended December 31</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2013	\$ 10,563	\$ 6,000
2014	10,188	6,000
2015	9,781	7,000
2016	9,312	8,000
2017	8,812	8,000
2018-2022	35,376	50,000
2023-2027	16,876	70,000
2028	531	17,000
Totals	<u>\$ 101,439</u>	<u>\$ 172,000</u>

2. Waterworks Revenue Bond Series 1991

On July 24, 1991, the District entered into an agreement with Rural Development to issue \$316,000 in Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2012, the principal balance outstanding was \$216,000. Debt service requirements for year ending December 31, 2012, and thereafter is as follows:

SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012

NOTE E - BONDS PAYABLE (CONTINUED)

2. Waterworks Revenue Bond Series 1991 (Continued)

Year Ended December 31	Scheduled Interest	Scheduled Principal
2013	\$ 10,600	\$ 8,000
2014	10,200	8,000
2015	9,800	8,000
2016	9,375	9,000
2017	8,925	9,000
2018-2022	37,000	54,000
2023-2027	21,550	70,000
2028-2030	3,800	50,000
Totals	<u>\$ 111,250</u>	<u>\$ 216,000</u>

3. Waterworks Revenue Bond Series 1992

On May 27, 1992, the District entered into an agreement with Rural Development to issue \$70,000 Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2012, the principal balance outstanding was \$51,700. Debt service requirements for year ending December 31, 2012, and thereafter is as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2013	2,546	1,600
2014	2,466	1,600
2015	2,383	1,700
2016	2,295	1,800
2017	2,203	1,900
2018-2022	9,453	11,000
2023-2027	6,317	14,200
2028-2032	2,332	17,900
Totals	<u>\$ 29,995</u>	<u>\$ 51,700</u>

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE E - BONDS PAYABLE (CONTINUED)

4. Waterworks Revenue Bonds Series 1995

On April 27, 1995, the District entered into an agreement with Rural Development to issue \$259,000 in Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 4.5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2012, the principal balance outstanding was \$201,000. Debt service requirements for year ending December 31, 2012, and thereafter is as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2013	\$ 8,922	\$ 5,500
2014	8,674	5,500
2015	8,415	6,000
2016	8,145	6,000
2017	7,864	6,500
2018-2022	34,504	37,500
2023-2027	24,941	47,500
2028-2032	13,176	58,500
2033-2034	1,282	28,000
Totals	<u>\$ 115,923</u>	<u>\$ 201,000</u>

5. Waterworks Revenue Bonds Series 2001

On June 20, 2001, the District entered into an agreement with Rural Development to issue \$495,000 Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 4.5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2012, the principal balance outstanding was \$439,500. Debt service requirements for year ending December 31, 2012, and thereafter is as follows:

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE E - BONDS PAYABLE (CONTINUED)

5. Waterworks Revenue Bonds Series 2001 (Continued)

<u>Year Ended December 31</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2013	\$ 19,609	\$ 7,500
2014	19,260	8,000
2015	18,889	8,500
2016	18,507	8,500
2017	18,113	9,000
2018-2022	83,869	52,500
2023-2027	70,651	65,000
2028-2032	54,294	81,000
2033-2037	33,909	101,000
2038-2041	9,124	98,500
Totals	<u>\$ 346,225</u>	<u>\$ 439,500</u>

6. Long Term Debt Maturity in the Aggregate

<u>Year Ended December 31</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2013	\$ 52,240	\$ 28,600
2014	50,788	29,100
2015	49,268	31,200
2016	47,634	33,300
2017	45,917	34,400
2018-2022	200,202	205,000
2023-2027	140,335	266,700
2028-2032	74,133	224,400
2033-2037	35,191	129,000
2038-2041	9,124	98,500
Totals	<u>\$ 704,832</u>	<u>\$ 1,080,200</u>

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE E - BONDS PAYABLE (CONTINUED)

7. Changes in Long-term Liabilities

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
<u>Business-type Activities:</u>					
Revenue Bonds	\$ 1,108,200	\$	\$ 28,000	\$ 1,080,200	\$ 28,600
Business-type Activities					
Long-term Liabilities	<u>\$ 1,108,200</u>	<u>\$ 0</u>	<u>\$ 28,000</u>	<u>\$ 1,080,200</u>	<u>\$ 28,600</u>

NOTE F – NET POSITION

Equity is classified as net position and displayed in three components:

- Invested in capital assets, net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets;
- Restricted net position - resulting from constraints placed on net position by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; and
- Unrestricted net position - those assets that do not meet the definition of restricted net position or invested in capital assets.

NOTE G - RETIREMENT

The District has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement System. This is a cost-sharing multiple-employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Benefit contributions and provisions are established by statute.

Nonhazardous covered employees are required to contribute 5 percent of their salary to the plan. Nonhazardous covered employees who begin participation on or after September 1, 2008 are required to contribute 6 percent of their salary to be allocated as follows: 5% will go to the member's account and 1% will go to the KRS insurance fund. The District's contribution rate for nonhazardous employees was 18.96 percent for the first six months of 2012 and 18.89 percent for the last six months of 2011.

The District's contribution for calendar year 2011 was \$32,185 and 2012 was \$32,251.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE G - RETIREMENT (Continued)

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months service credit.

CERS also provides post retirement health care coverage as follows:

For member participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

<u>Years of Service</u>	<u>% Paid by Insurance Fund</u>	<u>% Paid by Member through Payroll Deduction</u>
20 or more	100%	0%
15-19	75%	25%
10-14	50%	50%
4-9	25%	75%
Less than 4	0%	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502) 564-4646.

NOTE H - INSURANCE COVERAGE

The District is exposed to various risks of loss. The District carries commercial insurance for risks of loss. As of December 31, 2012, there were no known losses for which an accrual was considered necessary and no estimated claims that have been incurred, but not reported.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2012**

NOTE I – SUBSEQUENT EVENTS

Subsequent events have been evaluated through October 21, 2013, which is the date the financial statements were available to be issued.

NOTE J – COMPENSATED ABSENCES

It is the District's policy to permit its employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave because the District does not have a policy to pay any amounts when employees separate from service with the District. The unused vacation or annual leave is considered a vested employee benefit.

In recognition of the resulting obligation, the District has accrued a liability for earned but unused vacation leave, having determined that payment of such compensation is probable and having developed a reasonable estimate based upon current salary costs and annual leave balances as of December 31, 2012. The liability for compensated absences at December 31, 2012 was \$4,277.

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**Independent Auditors' Report On Internal Control Over Financial Reporting And On
Compliance And Other Matters Based On An Audit Of Financial Statements Performed In
Accordance With *Government Auditing Standards***

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Sandy Hook Water District, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise Sandy Hook Water District's basic financial statements, and have issued our report thereon dated October 21, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of Sandy Hook Water District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying comments and recommendations, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the

Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

accompanying comments and recommendations listed as items 2012-1, 2012-2, 2012-3, 2012-4, 2012-5, 2012-6, 2012-7, 2012-8, and 2012-9 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying comments and recommendations listed as items 2012-10, 2012-11, and 2012-12 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Sandy Hook Water District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying comments and recommendations as items 2012-13, 2012-14, 2012-15, 2012-16, 2012-17, 2012-18, and 2012-19.

Sandy Hook Water District's Response to Findings

Sandy Hook Water District's responses to the findings identified in our audit are described in the accompanying comments and recommendations. The District's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky
October 21, 2013

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

MATERIAL WEAKNESSES

2012-1 The District Should Establish A Risk Assessment Process

Condition: During our audit, we noted that the District does not have a risk assessment process necessary to determine where and how fraud can exist and ensure that controls are in place to prevent fraud from occurring.

Criteria: The District should have in place a process for detecting the existence of or potential for fraud.

Effect: Fraud could exist and not be detected by the commissioners or management.

Cause: Lack of understanding of the risk assessment process and a District's responsibility for developing controls to prevent fraud.

Recommendation: The commissioners and management should have open discussions to determine where and how fraud could exist and what procedures they currently have in place that could allow misappropriation of funds. Once they have determined where and how fraud could exist they should implement compensating controls to help alleviate the possibility of material fraud occurring.

District's Response: A Risk Assessment Process was written and approved by the Board of Commissioners on February 14, 2013. Please note that the exit conference was held in January 2013 for the 2011 exit.

Auditors' Response: The 2011 exit was conducted on December 19, 2012.

2012-2 The District Should Have Adequate Internal Controls Over Adjustments

Condition: The District does not have a written policy for applying and calculating adjustments. Board approval is not required to make an adjustment to a customer's account. During our audit, we tested five adjustments; one billing error adjustment, three leak adjustments and one misread adjustment. We recalculated the leak adjustments based on the procedures used by the District per inquiry of the assistant manager. The adjustments did not appear to be calculated in accordance with these procedures. There was no supporting documentation for the misread adjustment. We also noted while scanning a customer history report for a particular customer that a bill of \$106.90 was generated for a usage of less than 2,000 gallons. This bill should have been a minimum bill in the amount of \$17.60.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

MATERIAL WEAKNESSES (CONTINUED)

2012-2 The District Should Have Adequate Internal Controls Over Adjustments (Continued)

Criteria: The District should establish a written policy for applying and calculating adjustments. It is a good internal control policy to present proposed adjustments to the board and receive approval before adjusting customer accounts. District personnel should also ensure all adjustments are accurate.

Effect: Inaccurate or inappropriate adjustments to accounts could occur and not be detected in a timely manner.

Cause: The District's lack of internal controls over adjustments.

Recommendation: We recommend that the District establish a written policy for applying and calculating adjustments. We also recommend that adjustments be presented to the board for approval before adjustments are made to customer accounts. This should be documented in the official minutes. Furthermore, we recommend that someone check the mathematical accuracy of the adjustment prior to the adjustment being posted to the customer's account.

District's Response: A written policy was revised in the Tariff revision in June, 2013 and approved by the PSC. All adjustments are presented to the board on a monthly basis for board approval. Adjustments are followed by Tariff.

2012-3 The Commissioners Should Approve The Opening And Closing Of All Bank Accounts

Condition: We noted that the District closed a sewer account during September of 2012. No approval was noted in the minutes.

Criteria: It is a good internal control policy for the commissioners to approve the opening and closing of all bank accounts. Commissioners should be knowledgeable of all bank accounts held at financial institutions.

Effect: Misappropriation of assets could occur and not be detected in a timely manner. Accounts were opened and closed without approval.

Cause: Lack of policies and procedures for the opening and closing of bank accounts.

Recommendation: We recommend that the commissioners approve the opening and closing of all bank accounts and this approval be documented in the official minutes.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

MATERIAL WEAKNESSES (CONTINUED)

2012-3 The Commissioners Should Approve The Opening And Closing Of All Bank Accounts (Continued)

District's Response: The commissioners did approve to close bank account. By mistake they did not vote and put in minutes.

2012-4 The District Should Have Adequate Internal Controls Over Disbursements

Condition: During our audit, we tested twenty-five disbursements and noted the following:

- Purchase orders were not utilized.
- The District utilized a debit card.
- One instance in which it could not be determined if an expenditure was coded correctly.
- Six instances in which authorized signatures were not required because the transaction was a point of sale transaction (Debit Card) or an on-line transaction.
- One instance in which an invoice was not paid timely.
- Ten instances in which approval of disbursements was not properly documented.
- Four instances in which invoices were not properly coded.
- One instance in which a bill was included on the bills list, however, the bills list was not authenticated by the board member signatures.

Criteria: The following are examples of good internal controls:

- Purchase orders are a good way to track purchases and that the amounts invoiced are the amounts originally approved.
- Per KRS 65.140, unless the purchaser and vendor otherwise contract, all bills for goods or services shall be paid within thirty working days of receipt of a vendor's invoice except when payment is delayed because the purchaser had made a written disapproval of improper performances or improper invoicing by the vendor or by the vendor's subcontractor. An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty days which followed receipt of vendor's invoice by the purchaser.
- The Board should approve all expenditures. Management should present a listing of individual checks for approval. The Board should include this as part of their official minutes and sign off on the bills list.
- Invoices should be properly coded.
- The Department for Local Government Budget Manual strongly discourages the use of debit cards because they allow for weak control over disbursements.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

MATERIAL WEAKNESSES (CONTINUED)

2012-4 The District Should Have Adequate Internal Controls Over Disbursements (Continued)

Effect:

- Purchases may be made without proper approval.
- Expenditure categories are under or overstated.
- Penalties and interest could be incurred.
- Without documentation to determine the actual bills approved, bills could be paid without the Commissioners' knowledge.
- Weak controls over disbursements.
- Related party transactions could occur without board knowledge.

Cause: Lack of adequate internal controls over disbursements.

Recommendation: We recommend the District reevaluate their controls over disbursements to determine the controls that would best address the findings listed under the condition section above. The District may determine the controls listed above under the criteria section are adequate or may decide to implement other controls to eliminate such internal control weaknesses in the future.

District's Response: All disbursements for unpaid bills do have a purchase order. They are presented to the board on a monthly basis for approval before being paid. Minutes reflect approval, however, some months commissioners failed to sign list but this has been corrected in 2013.

Commissioners have discussed the use of the debit card. Debit card was voted upon being used and passed. It is used for when having to order parts, traveling, paying reports online. All purchases are presented on the prepaid bill list each month and listed as "debit" and receipts are there for the commissioners to look over. Passed on January 11, 2013.

The Misc code will no longer be used. All codes now reflect an explanation for transaction. Some vendors send out invoices quarterly. We have no control over their invoice dates. When we receive the invoice, it is paid within 30 days.

Auditors' Response: Of the twenty-five disbursements tested, no purchase orders were noted. Furthermore, ten disbursements did not have proper documentation of board approval.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

MATERIAL WEAKNESSES (CONTINUED)

2012-5 Adequate Financial Information Is Not Being Presented To And Approved By The Board Members

Condition: During our audit, we noted that the board members are not presented balance sheets, income statements or budget to actual comparisons. It appears the 2012 budget was not completed and filed with the County until January 14, 2013, and the budget had expenditures exceeding revenues.

Criteria: The board members should be given financial information in order to accurately monitor the financial position of the District and make informed financial decisions. The board members are the governing body responsible for monitoring all financial activity. Per KRS 65.065 the governing body of each district shall annually prepare a budget and, as appropriate, shall classify budget units in the same fashion as county budgets are classified in accordance with KRS 68.240(2) to (5). No monies shall be expended from any funds or any sources, except in accordance with the budget which has been filed with the fiscal court to be available for public inspection. No budget of a district shall become effective until filed with the fiscal court of the county in which the district is located for submission to the Department for Local Government. If the budget is not filed with the fiscal court at least thirty (30) days prior to the start of the district fiscal year, the fiscal court shall immediately notify the county attorney. The county attorney shall then notify the governing board of the special district of the noncompliance and then proceed with any steps necessary to prevent the expenditure of funds by the special district until the district is in compliance. The District should not budget for a deficit.

Effect: Without adequate financial information, the commissioners cannot effectively monitor financial activities or make informed financial decisions.

Cause: Failure to provide adequate information to the board members, obtain approval of annual budgets and submit annual budgets to the fiscal court at least thirty (30) days prior to the start of the District's fiscal year. The District budgeted for a deficit.

Recommendation: We recommend the commissioners be provided with a balance sheet, income statement and a budget to actual comparison schedule at monthly meetings. We also recommend that the District prepare and submit budgets timely and ensure budgeted expenditures do not exceed budgeted revenues.

District's Response: Reports have been presented to the board in 2013.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

MATERIAL WEAKNESSES (CONTINUED)

2012-6 The District Lacks Adequate Internal Controls Over Payroll

Condition: While performing payroll testing we noted the following:

- a) Bonuses appear to have been paid to employees.
- b) Employee withholdings for health insurance were not calculated correctly.
- c) One instance in which the hours used to calculate payroll did not agree to the employee's timesheet.
- d) Personnel files were not being maintained in accordance with the District's policy.

Criteria: It is a good internal control policy for the District to:

- a) According to the Department for Local Government's budget manual under section labeled "Handling Public Funds, Minimum Requirements Pursuant To KRS 68.210, for all Local Government Officials (And Employees)", bonuses, prepayment for goods or services, or any other contributions are NOT an appropriate expense of the government unless the official has implemented an incentive program under the guidelines of the administrative code.
- b) According to the District's agreement with the Department for Employee Insurance of the Kentucky Personnel Cabinet (DEI) dated February 3, 2008, the District agrees that it will contribute an amount at least equal to the Commonwealth's contribution. The District should annually determine the Commonwealth's contribution and amend their policies to reflect new rates. Rates should be properly calculated and withheld from employee checks.
- c) Hours used to calculate payroll checks should agree to timesheets.
- d) Ensure personnel files are maintained in accordance with the District's policies and procedures. Per the District's policies and procedures personnel files should contain the following:
 - o Copy of employment application (if applicable);
 - o Employees name, permanent address, and telephone number where employee can be reached;
 - o Position title;
 - o Date of employment;
 - o Salary;
 - o Fair Labor Standards Act and state labor law requirements;
 - o Commendation/reprimands;
 - o Drug free statement;
 - o I-9 Employment Eligibility Verification form;
 - o Certificated of receipt of personnel policies and procedures; and

**SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012**

MATERIAL WEAKNESSES (CONTINUED)

2012-6 The District Lacks Adequate Internal Controls Over Payroll (Continued)

Criteria (Continued):

- Such additional information as may be required.
- Ensure state unemployment, Kentucky withholding and Retirement reports are accurate.

Effect:

- a) Employees received unallowable payments.
- b) Employee withholdings for health insurance were not accurate. The District could be over/under paying their portion of health insurance premiums.
- c) An Employee was paid .75 hours less than the hours that were indicated on her timesheet.
- d) Inadequate documentation maintained in personnel files.

Cause: The District lacks adequate internal controls over payroll.

Recommendation: We recommend the District reevaluate their controls over payroll to determine the controls that would best address the findings listed under the condition section above. The District may determine the controls listed above under the criteria section are adequate or may decide to implement other controls to eliminate such internal control weaknesses in the future. We also recommend the District follow their established procedures.

District's Response: Employee insurance was corrected and the correct amounts have been held out in 2013.

[Employee] was shorted ¾ of an hour on her paycheck in Aug 2012. This was added to her check on the Oct 26, 2013 payroll.

At the end of the 2011 audit exit, all personnel files were updated with all required information. An employee incentive plan is being utilized.

Auditors' Response: The 2011 exit was conducted on December 19, 2012.

2012-7 The District Lacks Adequate Internal Controls Over Inventory

Condition: The District maintains inventory of items needed to make minor repairs to the water distribution system. The District does not track inventory that is utilized by maintenance employees for such repairs.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

MATERIAL WEAKNESSES (CONTINUED)

2012-7 The District Lacks Adequate Internal Controls Over Inventory (Continued)

Criteria: The District should track all transactions involving inventory. Whenever maintenance employees use inventory they should document the part number, the dollar value of the part, the date, and their initials at a minimum. This information should be used to update the inventory balances.

Effect: Misappropriations of inventory could occur and not be detected in a timely manner.

Cause: Lack of adequate internal controls over inventory.

Recommendation: We recommend the District establish adequate internal controls over inventory.

District's Response: District will be scrapping all inventories that are useless to the District that was donated.

2012-8 The District Should Have Adequate Controls Over The Preparation Of The Financial Statements Being Audited

Condition: The District should have adequate controls over the preparation of the financial statements being audited.

Criteria: SAS 115 states that an entity must have sufficient controls in place to prepare a full set of GAAP financial statements, including full disclosures.

Effect: Management may not be able to identify deficiencies in reporting.

Cause: Lack of controls over the preparation of the financial statements.

Recommendation: We recommend that The District's management develop adequate controls over the preparation of the financial statements.

Management may engage a qualified individual with suitable skills to review the draft audit in order to advise management sufficiently for them to be able to take responsibility for the financial statements.

Or management could implement the following controls.

1. Review draft financial statements by comparing to year-end QuickBooks reports that were prepared by management.

**SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012**

MATERIAL WEAKNESSES (CONTINUED)

2012-8 The District Should Have Adequate Controls Over The Preparation Of The Financial Statements Being Audited (Continued)

Recommendation (Continued):

2. Read footnotes accompanying the financial statement to ensure no discrepancies between footnotes and financial statements.
3. Review a disclosure checklist and compare to the footnotes for omitted or inaccurate disclosures.

These controls could be documented by initialing and dating the draft financial statement and disclosure checklist.

District's Response: In 2013 we hope to be able to provide a set of GAAP Financial statements.

2012-9 The Sandy Hook Water District Accounting Personnel Should Be Adequately Trained

Condition: During the course of our audit, we noted that the District's accounting personnel requires additional accounting training. We noted numerous correcting journal entries throughout 2012. Furthermore, an outside accountant was paid \$22,438 during the calendar year ended December 31, 2012 to prepare financials sufficient to audit. The Manager began using QuickBooks for the 2013 calendar year. She is having difficulty with bank reconciliations. She requested our assistance with the bank reconciliations. We explained that the problem was occurring because cleared transactions are being deleted. During our subsequent review of the profit and loss statement and balance sheet from QuickBooks, we noted that interest expense is recorded as a liability, payroll liabilities are not being recorded properly, and sewer collection payments made to the City of Sandy Hook are being recorded as an expense, however, there is no revenue account for sewer revenues collected.

Criteria: Accounting personnel should be adequately trained so that additional costs are not incurred to perform the same function.

Effect: Additional costs were incurred to adjust the financial statements and perform the annual audit.

Cause: The lack of adequate training of accounting personnel.

Recommendation: We recommend that the District's accounting personnel receive adequate training to meet the requirements of their job duties.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

MATERIAL WEAKNESSES (CONTINUED)

2012-9 The Sandy Hook Water District Accounting Personnel Should Be Adequately Trained (Continued)

District's Response: Accounting personnel will continue to take continuing education with the Alliance System. Quick Books will no longer be used.

SIGNIFICANT DEFICIENCIES

2012-10 The District Should Review The Deposit Account Monthly To Determine Whether Money Should Be Transferred To The Revenue Account

Condition: During our audit, we noted that funds due from the Deposit account to the Revenue account were not being transferred.

Criteria: Customer deposits that have been applied to a customer's account should be transferred to the revenue account as earned or at least monthly.

Effect: Revenues earned and applied to a customer's account remain in the customer deposit bank account.

Cause: When customer deposits are applied to the customer's bill, the District is failing to transfer this money to the revenue account.

Recommendation: We recommend that a review of the Deposit account be performed on a monthly basis to determine the amount of funds to be transferred to the revenue account and a check be written accordingly.

District's Response: Beginning in 2013, each month when refunding deposits to customers, all revenue is transferred to the Revenue account with a check being written accordingly.

2012-11 The District Should Establish A Policy Regarding Related Party Transactions

Condition: During our audit, we noted the District does not have a policy for related party transactions.

Criteria: The policy should include requiring yearly financial disclosures of related party transactions by board members and employees. The policy could also require disclosure of related party transactions as board members and employees become aware such a transaction has occurred.

Effect: The District may not be aware of all related party transactions.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

SIGNIFICANT DEFICIENCIES (CONTINUED)

2012-11 The District Should Establish A Policy Regarding Related Party Transactions (Continued)

Cause: The District has not implemented a related party transaction policy.

Recommendation: We recommend the District establish a policy regarding related party transactions.

District's Response: A related Party Transaction was adopted by the Commission on Feb 14, 2013.

2012-12 The District's Tariff Should Be Updated

Condition: While performing our audit, we noted the procedures in the tariff relating to customer deposits were not the actual procedures the District utilizes. The District charges \$50 for customer deposits and deposits are not refunded until the customer terminates service with the District. Per the tariff the customer's deposit should be based upon actual usage of the customer at the same or similar premises for the most recent 12-month period, if such information is available. If usage information is not available, the deposit will be based on the average bills of similar customers and premises in the system. The tariff also states that deposits will be waived upon a customer's showing of satisfactory credit or payment history, and required deposits will be returned after one year if the customer has established a satisfactory payment record for that period.

Criteria: The tariff should reflect actual and accurate procedures of the District.

Effect: The actual customer deposit procedures utilized do not agree with the procedures prescribed by the District's tariff.

Cause: Failure of the Board to review the tariff on a regular basis to ensure procedures implemented are in agreement with the District's tariff.

Recommendation: We recommend the District update the tariff to reflect actual procedures of the District or comply with the procedures prescribed by the tariff.

District's Response: The Tariffs were revised, filed with PSC and approved on June 18, 2013.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

NONCOMPLIANCES

2012-13 Interest Should Be Applied To Customers' Deposits As Earned In Accordance With KRS 278.460

Condition: While performing our audit, we noted that the District is not applying interest to customer's accounts. Of the five refunds tested, none included interest earned.

Criteria: Per KRS 278.460, at minimum, the District shall pay the interest that is earned on the deposits to the patrons when returning the deposit or applying the deposit to offset the patrons' accounts.

Effect: Customers are not being refunded amounts as required by KRS 278.460.

Cause: Failure to monitor customer balances and implement procedures for calculating interest earned on deposits.

Recommendation: We recommend that the District determine if the software has the capability to apply interest earned on the customer deposit bank account to each customer's balance on a monthly basis. If the system does not have this capability, we recommend that the District implement other procedures to ensure compliance with KRS 278.460.

District's Response: Interest applied yearly due to customers only earning four cents (.04) per year. It is impossible to apply months.

Auditors' Response: Whether applied annually or monthly, deposit refunds should include interest due to the customer.

2012-14 The District Should Adequately Fund The Reserve Account As Required By Bond Covenants

Condition: During our audit, we noted the District does not have sufficient funds in the reserve bank account. The balance in the reserve bank account was \$86,260 and the required reserve balance as of December 31, 2012 was \$94,400, leaving it under funded by \$8,140.

Criteria: According to bond covenants the District's required reserve balance as of December 31, 2012 was \$94,400.

Effect: Under funding of the reserve bank account in the amount of \$8,140.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

NONCOMPLIANCES (CONTINUED):

2012-14 The District Should Adequately Fund The Reserve Account As Required By Bond Covenants (Continued)

Cause: Lack of adequate controls over compliance with bond covenants.

Recommendation: We recommend the District adequately fund their reserve bank account as required by bond covenants and deposit \$2,760 annually until the 2001 Bond Issue is paid in full.

District's Response: Per Rural Development, both by letter and by phone, the fully funded amount of the Depreciation Account is \$86,040.00. Am attaching copies of email and letter from USDA Rural Development.

See attachments in Appendix A on page 43.

Auditors' Response: Pursuant to the bond covenants obtained from the client, the required reserve balance at December 31, 2012 was \$94,440. Per our inquiry of Rural Development personnel, Rural Development calculates required reserve balances based on a ten-year period regardless of what the bond documents require. They calculate these amounts for the entity and send a letter with the amounts as a courtesy. The correspondence is not an official document. We determined the required reserve based on the bond covenants.

2012-15 The District Should Submit Documentation To The Fiscal Court And County Clerk As Required By KRS 65.070

Condition: During our audit, we noted the District failed to file the documentation required by KRS 65.070.

Criteria: KRS 65.070 states:

(1) Within sixty (60) days following the close of the fiscal year, the district shall:

(a) File with the county clerk of each county with territory in the district a certification showing any of the following information that has changed since the last filing by the district:

1. The name of the district;
2. A map or general description of its service area;
3. The statutory authority under which it was created; and
4. The names, addresses, and the date of expiration of the terms of office of the members of its governing body and chief executive officer;

(b) Submit for review a copy of the summary financial statement with the fiscal court of each county with territory in the district; and

**SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012**

NONCOMPLIANCES (CONTINUED):

2012-15 The District Should Submit Documentation To The Fiscal Court And County Clerk As Required By KRS 65.070 (Continued)

Criteria (Continued):

(1) (Continued)

(c) Publish, in lieu of the provisions of KRS 424.220, but in compliance with other applicable provisions of KRS Chapter 424, the names and addresses of the members of its governing body and chief executive officer, and either a summary financial statement, which includes the location of supporting documents, or the location of district financial records which may be examined by the public.

(2) The district shall submit for review a copy of the audit with the fiscal court of each county with territory in the district. The submission shall be made within thirty (30) days.

Effect: Adequate information was not provided to the fiscal court or county clerk.

Cause: The District's failure to file required documentation as prescribed by KRS 65.070.

Recommendation: We recommend the District comply with KRS 65.070 and file required information with the clerk and fiscal court.

District's Response: The required paperwork to the Clerk's office and the Fiscal Court will be delivered in a timely manner.

2012-16 An Annual Statement Of Receipts And Disbursements Should Be Prepared And Made Available To Customers

Condition: While performing our audit, we noted the district did not prepare and make available to customers an annual statement of receipts and disbursements.

Criteria: KRS 74.240(2) states the commission shall be required to prepare and make available, to the consumers of the water supplied by any water district, an annual statement of receipts and disbursements; and any floating or bonded indebtedness. This report shall show the cost of water, material, labor, other salaries and any other expenses incidental to the operation and maintenance.

Effect: The financial position of the District was not made known to consumers.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

NONCOMPLIANCES (CONTINUED):

2012-16 An Annual Statement Of Receipts And Disbursements Should Be Prepared And Made Available To Customers (Continued)

Cause: The District's failure to provide such information as required by KRS 74.240(2) to consumers.

Recommendation: We recommend the District prepare an annual statement of receipts and disbursements and make it available to customers as required by KRS 74.240(2).

District's Response: A copy of receipt for the filing of the annual report was given to the auditor. A call was made to [representative] to find out why the report wasn't being shown on line. This issue is being resolved. The report was submitted and received.

2012-17 The District Should Have An Audit Performed No Later Than Sixty Days After The Close Of Each Fiscal Year

Condition: The District did not have an audit performed within sixty days after the close of the fiscal year.

Criteria: Per the District's bond covenants an annual audit shall be made of the books and accounts pertinent to the system by a certified public accountant licensed in Kentucky. No later than sixty days after the close of each fiscal year, copies of such audit reports certified by such certified public accountant shall be promptly mailed to the FMHA without request.

Effect: Audits are not being performed timely.

Cause: The District's failure to have the general ledger in balance in a timely manner to allow a certified public accountant to have the audit completed within sixty days after the close of the fiscal year.

Recommendation: We recommend the District have an audit performed no later than sixty days after the close of each fiscal year or request an extension.

District's Response: The District will have everything ready for the auditor in a timely manner for the 2013 audit.

SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012

NONCOMPLIANCES (CONTINUED):

2012-18 The District Should Transfer Each Month From The Revenue Account An Amount Sufficient To Meet Current Expenses Of The District To The Operating And Maintenance Account

Condition: While performing our audit, we noted that the District did not prepare a budget until December 2012. The District could not have determined that the balance maintained in the operation and maintenance fund did not exceed anticipated expenditures for a two-month period pursuant to the District's annual budget.

Criteria: Per the bond covenants there shall be transferred each month from the water revenue account, an amount sufficient to meet the current expenses of operating and maintaining the system. The balance maintained in said operation and maintenance fund shall not be in excess of the amount required to cover anticipated expenditures for a two month period pursuant to the District's annual budget.

Effect: The balance in the operation and maintenance fund could have exceeded the amount permitted by the bond covenants.

Cause: Failure to monitor the operation and maintenance balance.

Recommendation: We recommend the District monitor the operation and maintenance balance as required by the bond covenants.

District's Response: A budget will be completed on time this year. The amounts deposited to cover operation expenses vary from month to month. Some months a larger amount is required and other months not as much due to insurance policies etc coming due.

2012-19 The District Should Escrow Customer Deposits That Cannot Be Returned

Condition: While performing our audit, we noted the District had some customer deposits on hand that were due back to customers that were undeliverable.

Criteria: The District should deposit any unrefundable payments and unexplained receipts in an interest-bearing account. According to KRS 393.110, the District should properly report annually to the Treasury Department any unclaimed moneys. After three years, if the funds have not been claimed, the funds should be submitted to the Kentucky State Treasurer.

Effect: Customers entitled to a refund are not being refunded their deposits.

Cause: Failure to escrow any undeliverable customer deposits in accordance with KRS 393.110.

**SANDY HOOK WATER DISTRICT
Comments and Recommendations
For the Year Ended December 31, 2012**

NONCOMPLIANCES (CONTINUED):

**2012-19 The District Should Escrow Customer Deposits That Cannot Be Returned
(Continued)**

Recommendation: We recommend the District deposit any undeliverable refunds into an interest-bearing account and properly report to the Treasury Department as required by KRS 393.110.

District's Response: An escrow account is being set up for the small amount of deposits returned that cannot be delivered.

ATTACHMENTS TO DISTRICT'S RESPONSE 2012-14

SANDY HOOK WATER DISTRICT

**For the Year Ended
December 31, 2012**

Appendix A



United States Department of Agriculture
Rural Development
Morehead Area Office

October 23, 2012

Sandy Hook Water District
PO Box 726
Sandy Hook, KY 41171

RE: **Annual Management Report Requirements**

Dear Borrower,

This letter is a reminder of your annual management report requirements in accordance with applicable Rural Development regulations.

You should submit two copies of your proposed Annual Budget for the next fiscal year on Form RD 442-2, "Statement of Budget, Income and Equity," Schedule 1, Page 1 and Schedule 2, Projected Cash Flow, to this office thirty days prior to the end of your current fiscal year. The only data you are required to complete at this time is Schedule 1, Page 1, Column 3, Annual Budget, and all of Schedule 2, Project Cash Flow.

If your facility primarily provides fire and rescue services, you may, with the concurrence of the Area Director, use Form RD 1942-53, "Cash Flow Report," instead of Schedules 1 and 2 of Form RD 442-2. The cash flow statement should be projected for the upcoming fiscal year

The Rural Development payment, which should be budgeted for next year is

Interest.....\$52,237.50
Principal.....\$28,600.00

You are also reminded that the required deposits to the Reserve Account are \$2,760.00 annually and must be budgeted as required by the Bond Resolution/Ordinance or Loan Agreement. The required Reserve Account Balance at the end of the budget year is \$86,040.00. If your reserve balance is below the required level, you must increase deposits to bring the account to the required level as soon as possible. The fully funded reserve level is \$86,040.00.

220 West First Street • Morehead, KY 40351
Phone: (606) 784-6447 • Fax: (606) 784-2076 • TDD: (859) 224-7422 • Web: <http://www.rurdev.usda.gov/ky>

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Subject: RD Depreciatino Reserve Account
From: Hoff, Douglas - RD, Morehead, KY (douglas.hoff@ky.usda.gov)
To: sandyhookwater@yahoo.com;
Date: Monday, October 28, 2013 9:29 AM

Trina

Your depreciation reserve account is considered fully funded at \$86,040

It appears from your email below that your depreciation reserve account is over funded.

Should you have questions, feel free to call

Thank you in advance

Doug

Douglas T Hoff

Area Specialist

United States Department of Agriculture

Rural Development

220 West First Street

Morehead, Kentucky 40351

Voice: 606.784.6447 Ext 116 • Fax: 606.784.2076

Cell : 606.356.6904

Email: douglas.hoff@ky.usda.gov

www.usda.gov

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Dear Amie,

I was recently written up by our auditor for being underfunded in my Reserve account. I have a balance as of 12-31-2012 was \$86,259.00. I was written up for it. Currently the balance is \$97,539.47.

On the Reserve Requirements that I have, it shows that the Reserve is fully funded when the balance is \$86.040.00.

Can you tell what the requirements are for for the Sandy Hook Water District? I need to know if the auditor is right and I need to continue to deposit into this account or if it is in fact fully funded.

Thank you in advance for your help with this matter.

Trina Sartaine
General Manager
P O Box 726
Sandy Hook, KY 41171

606 738 6282 Ext 102

606 738 6292 Fax

606 923 1433 Cell

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